FISCAL NOTE

Bill #: HB749 **Title:** Statewide general retail sales and use tax

Primary Sponsor: Jim Peterson **Status:** As Introduced

Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
General Fund	$9,210,049	($342,590,805)
State Special Revenue	$222,699,000	$459,379,000
Revenue:		
General Fund	$169,632,000	($299,486,000)
State Special Revenue - Sales Tax Account	$222,699,000	$459,379,000
Net Impact on General Fund Balance:	$160,421,951	$43,104,805

☒ Significant Local Gov. Impact

☐ Included in the Executive Budget

☒ Dedicated Revenue Form Attached

☒ Technical Concerns

☒ Significant Long-Term Impacts

☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

General Sales Tax

1. Beginning January 1, 2004, this bill would impose a 4% sales and use tax on retail sales of tangible personal property and services with the following exemptions: sales for resale or lease; health services; educational services; agricultural, forestry, fishing and hunting services; transportation except for unscheduled air passenger transportation surface passenger transportation other than transit and school and employee transportation; insurance commissions and premiums; rent or lease of a vehicle with over 1 ton capacity; services a corporation provides to an affiliate or subsidiary that is centrally assessed; telecommunications services subject to the retail telecommunications excise tax; gambling; sales by or to a government or tribe; advertising; unprepared food; prepared food that is part of a residential or health care arrangement; medicine, durable medical equipment, mobility enhancing equipment and therapeutic and prosthetic devices; construction materials used in commercial or public projects; agricultural inputs; agricultural products; minerals or chemicals used in processing ores; inputs used in mining or manufacturing; half the value of a mobile home;
2. During the six months of fiscal 2004 when the sales tax would be in effect, taxable sales would be $5,956.969 million, and tax liability would be $238.279 million. In fiscal 2005, taxable sales would be $12,283.270 million, and tax liability would be $491.331 million. Vendors would collect taxes equal to 95% of tax liability. This would be $226.365 million in fiscal 2004 and $466.764 million in fiscal 2005.

3. There would be 55,000 businesses collecting the tax on their sales.
4. Vendors with average tax liability of $100 per month or less would be allowed to file returns quarterly. Ten percent of vendors would file quarterly, and they would make 1% of taxable sales. Quarterly filers would retain 5% of their tax collections as a vendor allowance (see technical note 1). Total vendor allowances retained by this group of vendors would be 0.05% of taxes collected by vendors.
5. Monthly filers would retain 1.5% of collections as a vendor allowance with a maximum of $50 per month. There would be 9,295 vendors, accounting for 76.5% of taxable sales, who would retain vendor allowances of $50 per month. This group would retain vendor allowances of $5.577 million per year.
6. The remaining quarterly filers, accounting for 22.5% of sales, would retain vendor allowances of 1.5% of collections. This group would retain vendor allowances of 0.3375% of taxes collected by vendors.
7. Total vendor allowances would be $5.577 million per year plus 0.3875% of taxes collected by vendors.
8. Taxes collected by vendors, less vendor allowances, would be paid to the state. Sales and use tax collections would be $222.699 million in FY 2004 and $459.379 million in FY 2005. Sales tax revenue would be deposited in a special revenue account. This bill would create a statutory appropriation from the sales and use tax account for schools, and remaining revenue would be available for appropriation. At the end of each fiscal year, any unappropriated amount would revert to the general fund.

Individual Income Tax Reform

9. Beginning with tax year 2004 this bill would reform Montana's individual income tax by:
    a) eliminating the current law tax rate table with rates ranging from 2% to 11%, and taxing taxpayers at a single, flat rate of 5.75%;
    b) eliminating the current law itemized deduction for federal income taxes paid during the tax year;
    c) allowing taxpayers to deduct 50% of any net capital gains income reported for the year; and
    d) increasing the tax year 2004 personal exemption level for taxpayers, taxpayer spouses, and taxpayer dependents (but not the additional personal exemption for the elderly or the blind) from $1,840 to $5,740 (with annual indexing of this value thereafter).
10. Under this bill all married taxpayers will file joint returns as there is no incentive to file separate returns under a flat rate tax structure.
11. Taxpayers currently taking the standard deduction will itemized deductions if the new deduction for 50% of net capital gains income is larger than the standard deduction.
12. The Department of Revenue will adjust withholding tables beginning January 1, 2004 to take the net overall income tax reduction in this bill into account; taxpayers will also adjust their quarterly estimated tax payments to take any tax reductions or increases inherent in this bill into account.
13. Under this bill, tax liabilities of *full-year resident filers* will decrease by $(89.039) million in tax year 2004; by $(108.904) million in tax year 2005; and by $(116.112) million in tax year 2006. Under this bill, tax liabilities of *full-year resident filers* will decrease by $(89.039) million in tax year 2004; by $(108.904) million in tax year 2005; and by $(116.112) million in tax year 2006. Under this bill, tax liabilities *of all filers (including part-year and nonresident filers)* will decrease by $(99.600) million in tax year 2004; by $(123.553) million in tax year 2005; and by $(133.576) million in tax year 2006.
14. Under this bill, net collections to the state general fund, *before the tax credit for property taxes provided for in the bill are taken into consideration*, are reduced by $(53.067) million in fiscal 2004; by $(114.618) million in fiscal 2005; and by $(131.692) million in fiscal 2006.

Property Tax Credit Against Individual Income Taxes

15. Sections 62 and 64 allow for a school equalization credit, against individual income tax or corporation license or income tax, in an amount equal to the property tax reported to property taxpayers for the statewide mill levies (33, 22, 40 mills for the state general fund, and 6 mills for the university system). The credit is a *refundable* credit, meaning if the credit for the property taxes reported is more than the

amount of income tax owed, the excess must be refunded to the taxpayer. County treasurers will be required to itemize the total amount of tax due towards the statewide mills on the property tax notices sent to all property taxpayers.

16. Under the proposal, property taxes *reported* for statewide mill levies to taxpayers in calendar year 2004 would be allowable under the credit for individual and corporate income taxes paid in calendar year 2005 (fiscal 2005).
17. For purposes of this fiscal note it is assumed that all property taxes reported for the statewide mill levies will be claimed as a credit this includes taxes on statewide school levies that are retained by tax increment distics (TIF). It is estimated that the amount of property taxes due the statewide mill levies that will be reported to taxpayers in calendar year 2004 is $184,868,000. (HJR2 amended). This will increase to $193,004,000 in calendar year 2005 (impact in fiscal 2006).
18. Included in the calendar year total of $184,868,000 are taxes that will be paid under protest (see technical note 6).
19. Not included in the calendar year total of $184,868,000 are taxes due and delinquent for years other than the current tax year (see technical note 7).
20. The following table shows the combined impact of individual income tax reform and the total amount of property tax credits that will be claimed against either individual income tax or corporation license (income) tax:

HB749 Combined Impact on State General Fund Collections
Individual Income Tax Reform and
Combined Individual Income and Corporate Property Tax Credits

TY/FY	Change in Tax Year Liability: Full-Year Residents	Change in Tax Year Liability: All Filers	Change in Collections Before PT Credit	Total Property Tax Credits	**Net Change in General Fund Collections**
2004	$ (89.039)	$ (99.600)	$ (53.067)	$ -	**$ (53.067)**
2005	$ (108.904)	$ (123.553)	$ (114.618)	$ (184.868)	**$ (299.486)**
2006	$ (116.112)	$ (133.576)	$ (131.692)	$ (193.004)	**$ (324.696)**

Corporation License Tax

21. Section 77 of the bill allows corporation to take as a deduction 50% of any net total capital gains of the corporation in determining Montana tax liability. The Department of Revenue does not have sufficient information to provide an estimate of the impact of this provision of the bill. Generally speaking, this new deduction will act to reduce corporation license tax collections below their current law level, increasing the overall revenue reductions already discussed in earlier sections of this fiscal note.

Office of Public Instruction

22. HB749 allocates revenue from the sales and use tax to fully fund the BASE budgets of K-12 school districts. The bill eliminates the BASE levy property tax requirements of school districts.
23. HB749 eliminates the allocation of HB124 block grants to the school districts. The district general fund block grants are estimated at $43.005 million and all other funds are $10.896 million for a total of $53.901 million in FY 2005.
24. A school district will use its general fund balance reappropriated and any general fund non-levy revenues to reduce the property tax requirement for the over-BASE portion of the district general fund.
25. The basic and per-ANB entitlements are:

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(continued)

	FY 2003	FY 2004	FY 2005
Basic entitlement EL	$19,244	$19,244	$19,244
Basic entitlement HS	$213,819	$213,819	$213,819
Per-ANB entitlement EL	$3,906	$3,906	$3,906
Per-ANB entitlement HS	$5,205	$5,205	$5,205
Direct State Aid Percentage	44.7%	44.7%	44.7%

26. The statewide taxable valuation will increase by 4.0% in FY 2004 and by 5.5% in FY 2005.
27. The state will fund 100% of district BASE budgets from the guarantee account and the sales and use tax account in the state special revenue fund, except that non-isolated districts will continue to fund one-half of their direct state aid with a local levy (20-9-303).
28. District BASE levies and state guaranteed tax base subsidies for BASE levies are eliminated in FY 2005.
29. Common school trust income and income deposited in the Guarantee Account is the first source of financing for the state's obligation for direct state aid to schools. The balance of the state's annual obligation for direct state aid will be paid from the sales and use tax account.
30. Under current law, direct state aid will be $314.03 million in FY 2005. Special education payments will be $34.91 million in FY 2004 and FY 2005. Guaranteed tax base aid to school's general fund budgets will be $94.93 million in FY 2005. Direct state aid and guaranteed tax base aid are funded $44.017 million from the guarantee fund and $364.943 million from the state general fund.
31. HB749 does not affect the state special education appropriation.
32. Under HB749, direct state aid will be $575.35 million and guaranteed tax base aid to school's general fund budgets will be $0 in FY 2005. Direct state aid will be funded $44.017 million from the guarantee fund then from the sales and use state special revenue fund to the extent funds are available. Any excess obligation will be funded from the general fund. $435.312 million will be deposited in the sales and use tax fund in FY 2005, leaving a state general fund obligation for school direct state aid of $96.021 million.
33. The HB 124 block grants to school districts are eliminated in FY 2005.

Administrative Impacts
Department of Revenue

34. The Department of Revenue would need to implement a new data processing system to administer the sales and use tax. The department would buy software from an outside vendor, and the department and the vendor would customize it. The department also would make modifications to the existing income tax processing system. Cost for the system would be $6,231,384 in fiscal 2004 and $230,906 in fiscal 2005. Computers and office equipment for contract programmers would cost $42,837 in fiscal 2004. Beginning in fiscal 2006, ongoing costs for software maintenance and storage on the state's network would be $220,000.
35. In fiscal 2004, the Department of Revenue would need to register 55,000 taxpayers, develop and mail tax forms and instructions, conduct taxpayer education and outreach, and hire and train new staff to administer the sales tax. Beginning in calendar year 2004, the department would process approximately 620,000 returns and audit 1,100 taxpayers each year. The department would hire 61.88 FTE in fiscal 2004 for processing, compliance, and support work. In fiscal 2005, the department would hire an additional 27.37 FTE for compliance work. Personnel costs would be $1,928,779 in fiscal 2004 and $3,306,721 in fiscal 2005. Costs for computers and office equipment for the additional staff would be $397,570 in fiscal 2004 and $240,970 in fiscal 2005. Operating costs, including forms development, travel by auditors, and consulting services from an experienced sales tax administrator from another state would be $582,093 in fiscal 2004 and $520,598 in fiscal 2005. Ongoing costs would be the same as in fiscal 2005 except for the equipment costs.

Department of Justice

36. The Department of Justice, Motor Vehicle Division (DOJ/MVD) will absorb the cost of training the county treasurers and updating forms through normal operations within its present law operating budget.
37. The rulemaking process will increase operating costs approximately $1,500 in FY 2004.
38. Operating expenses will increase approximately $10,400 for programming and $15,486 for computer processing time paid to the Department of Administration in FY 2004 to add and track the vehicle sale sales price to the motor vehicle registration record in the database, change the processes to collect and report the value, add new fee codes for the sales tax and tax credit, allow the new sales tax fee code to automatically calculate sales tax based on sale value, update the motor vehicle report provided to the Department of Revenue to breakout the new tax category and report the sales tax and tax credits.

FISCAL IMPACT:	FY 2004 Difference	FY 2005 Difference
Department of Revenue		
FTE	61.88	89.25
Expenditures:		
Personal Services	$1,928,779	$3,306,721
Operating Expenses	6,813,477	751,504
Equipment	440,407	240,970
Transfers – Sales & Use Tax to GF	222,699,000	0
Subtotal – Dept of Revenue	$231,881,663	$4,299,195
Office of Public Instruction		
Local Assistance – School Base Aid	$0	$166,390,000
Local Assistance – School Block Grants	0	(53,901,000)
Subtotal – Office of Pub. Instr.	$0	$112,489,000
Department of Justice		
Operating Expenses	$27,386	$0
TOTAL ALL AGENCIES	$231,909,049	$116,788,195
Funding of Expenditures:		
General Fund (01)	$9,210,049	($342,590,805)
State Special Revenue (02)	222,699,000	459,379,000
TOTAL	$231,909,049	$116,788,195
Revenues:		
General Fund (01)	$169,632,000	($299,486,000)
State Special Revenue (02) - Sales Tax Acct	222,699,000	459,379,000
TOTAL	$392,331,000	$159,893,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$160,421,951	$43,104,805
State Special Revenue (02) - Sales Tax Acct	$0	$0

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

1. District BASE levies are eliminated. Levies in other district funds will increase as a result of eliminating the HB 124 block grants.

2. Due to the reduction in mills in the district general fund, in FY 2006 HB 749 would reallocate non-levy revenue that currently goes to the district general fund levies to local governments and other school districts funds. This would decrease other local levies. The amount of this redistribution has not yet been determined.
3. County treasurers will be required to itemize the total amount of tax due towards the statewide mills on the property tax notices sent to property taxpayers.

<u>LONG-RANGE IMPACTS:</u>
Individual income taxes will continue to be reduced by over $300 million in each year after fiscal year 2006. Sales tax revenue would grow by approximately 3.1% per year.

<u>TECHNICAL NOTES:</u>
Department of Revenue
1. Subsection 39(3)(b) allows vendors with average monthly tax liability of less than $100 to file quarterly tax returns. This threshold is equivalent to annual taxable sales of $30,000 ($100 = 4% x $30,000 / 12). Subsection 41(3)(b) allows quarterly filers to retain a vendor allowance of 5% of the tax with a maximum of $150 per quarter. This maximum is 5% of the tax on $75,000 of taxable sales ($150 = 5% x 4% x $75,000). Since quarterly filers must have annual sales of $30,000 or less, the vendor allowance would be 5% for all quarterly filers.
2. Subsections 16(2)(a) and 16(2)(b) appear to be redundant. A vehicle that is required to pay a fee for a maximum gross loaded weight of 1 ton or more under 61-10-201 is not a light vehicle as defined in 61-1-139.
3. Sections 13, 21 and 22 and subsection 24(b)(i) appear to be largely if not entirely redundant. Section 13 provides a very general exemption for purchases of goods and services used in agriculture, and non-retail sales by persons engaged in agriculture. Sections 21 and 22 and subsection 24(b)(i) provide narrower exemptions for agricultural purchases and sales.
4. It is not clear whether section 26 intends to exempt or tax the sale of used mobile homes and manufactured homes. This fiscal note assumes that the intent is to exempt these sales.
5. Section 26 exempts half of the value of a mobile home or manufactured home. A mobile home that is permanently located is considered an improvement to real property rather than personal property (see MCA 15-1-101(i)). Thus, the sale of a mobile or manufactured home that is permanently located before the buyer takes possession would not be subject to this tax.
6. Property taxpayers who pay under protest (15-1-402, MCA) are still entitled to the school equalization credit included in the bill. A taxpayer who is partly or completely successful in their protest will receive a portion of the property taxes paid to the statewide mill levies. This would result in the school equalization credit received being larger than the actual amount of property tax paid to the statewide mill levies.
7. Included on the property tax notice (15-16-101, MCA) is the amount of taxes due and delinquent for years other than the current tax year. As written, the proposal would allow the school equalization credit on the statewide mill levied portion of delinquent property taxes. This is in effect an amnesty on delinquent property taxes due the statewide mill levies.
8. Taxpayers are allowed a credit against individual or corporate taxes for property taxes *reported* on their tax bill, but not actually paid during the tax year. This represents a significant departure from convention, which generally allows deductions, exclusions, credits, etc. only for amounts actually paid during the tax year.
9. The credit for property taxes paid provided for in the bill is a *refundable* tax credit; that is, taxpayers are entitled to a refund of any amount by which the credit exceeds their tax liability. However, the bill is silent regarding the order of application of this credit in relation to other *nonrefundable* credits already

allowed under current law. If the refundable credit is required to be applied prior to application of the other credits, general fund collections would be greater in any year in relation to a system that allowed other credits to be applied before the refundable credit is applied.

10. Section 72 of the bill amends 15-30-112 to increase the personal exemption for the taxpayer and the taxpayer's spouse and dependents to $5,740. The revenue impacts in this fiscal note assume that the intent of the bill is to provide for a personal exemption level of $5,740 beginning in tax year 2004. If this is the case the bill must be amended to comport this assumption with the indexing provisions in the definitions section of law for the income tax (15-30-101).
11. Section 73 of the bill provides for a new "deduction" equal to 50% of the taxpayer's net capital gain. Because this change was incorporated by amending 15-30-121 (Deductions allowed in computing net income) for individual income tax purposes, only those taxpayers who itemize their deductions will get the benefit of this deduction; taxpayers who take the standard deduction would not. It is long- standing convention, at both the federal level and in other states, that preferential treatment of capital gains income be provided for through an *exclusion of income*, rather than through an *itemized deduction*. In this manner, both taxpayers who itemize their deductions and taxpayers who take the standard deduction would be afforded the benefit of the preferential treatment of capital gains income.
12. Section 11 exempts certain types of services from the sales and use tax. It defines those services with reference to the North American Industry Classification System (NAICS). The NAICS manual contains definitions of industries, not of goods and services. For example, subsection (a) exempts health services and cites NAICS sector 62. NAICS sector 62 consists of establishments whose primary function is providing health care and social assistance, but these establishments also sell a variety of other goods and services. For example, many hospitals have cafeterias or snack bars and gift shops. This fiscal note assumes that the exemptions in section 11 are for sales in the primary lines of business that define the NAICS industries referenced, not for all sales by establishments in those industries. The NAICS industry classification system was developed by the Census Bureau and its counterparts in Canada and Mexico. The agencies are in the process of developing the North American Product Classification System (NAPCS), which will be a classification system for goods and services. Preliminary NACPS definitions are available for some types of goods and services. Section 11 should reference NACPS definitions where they are available. Otherwise, the bill should provide definitions or leave definitions to the rulemaking process.
13. The information technology (IT) project required to implement this legislation would require the review and approval of the Chief Information Officer (CIO) as provided for in 2-17-512, MCA.
14. Implementation of this tax will require the Department of Revenue to implement a computer system to automate the administrative requirements of registration, return processing, customer and revenue accounting, and compliance activities. The expenditure will involve millions as shown by this estimate. Projects of this size are normally pursued through a Request For Proposal procedure outlined by the Department of Administration and can routinely take up to 6 months of careful planning and review before selecting a vendor or product that meets the department's requirements. The proposed effective and applicability dates in HB749 do not allow for the time required to proceed with the normal procurement processes defined in statute. Unless implementation of this act could be identified as an exception to those requirements, the effective date of the act may have to be amended to July 1, 2004 and applicable to sales occurring after June 30, 2004. Compressing timelines allotted to pre-project due diligence and vendor selection increases project risk.

Office of Public Instruction

15. All references to "guaranteed tax base aid" are stricken in sections 79, 91 and 94. These references should remain in those sections, since they apply to guaranteed tax base aid for school retirement.

16. Sections 82 and 86 contain neither new language nor amendments to existing language. It appears these sections were included in the bill because they contain references to the district BASE levy. HB 749 eliminates the district BASE levy.
17. Reference to the nonisolated district BASE levy provided for in 20-9-303 should not be stricken in 20-9-141(1)(a)(i).
18. The definition of BASE budget should include "40%" of the special education allowable cost payment, rather than "up to 40%."
19. Section 92 eliminates the payment schedule for retirement guaranteed tax base aid.
20. Section 101 contains neither new language nor amendments to existing language. It appears this section is included in the bill because of the reference to section 244, Chapter 574, Laws of 2001 which is repealed in HB 749.
21. Section 20-9-307 is not amended and says the BASE funding program for districts is financed from the 55 county equalization mills and the 40 mill levy for state equalization aid. Under HB 749, the revenue from those mill levies is deposited in the general fund and refunded to taxpayers through an income tax credit.
22. District impact aid revenue may be reduced as a result of refunding the 55 mill levy through an income tax credit and leaving the balance if any in the state general fund, rather than using those revenues as local effort to fund district BASE budgets.

Department of Justice

23. Section 16 describes the vehicles that would be exempted from the sales tax and use tax. Automobiles, vans, sport utility vehicles, or trucks having a manufacturer's rated capacity of more than one ton would be exempted from the sales tax or use tax under subsection 2(a). Clarification may be necessary as to whether automobiles, vans, sport utility vehicles with a manufacturer's rated capacity of exactly one ton and not required to pay a GVW fee would be exempt from the sales/use tax due to subsection 2(b) which states that vehicles that have a manufacturer's rated capacity of one ton or more and required to pay the GVW fees for 1 ton or more would be exempted.
24. Section 19 appears to indicate that sales of boats, snowmobiles, off-highway vehicles, and motor vehicles between individuals would be considered isolated or occasional sales and would be exempt from the sales tax and use tax.